

# NAVIGATING THE AUDIT TRAIL AND THE IMPORTANCE OF INTERNAL CONTROLS

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# Learning Objectives

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What is Auditing?

Types of Audits

External Audit vs. Internal Audit

Risk and Internal Controls

Case Studies

Responsibility for Internal Controls

Quiz

# What is Auditing?

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A methodical examination and review

Verification activity of a process or system to ensure compliance to requirements.

Can apply to an entire organization or might be specific to a function, process, or department.

Often associated with finances and accounting

Some audits, such as internal audits or information technology audits, do not involve financial activity

# What is an Audit Trail?

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A record of all the transactions or data entries that a person or firm has carried out over a specific period showing the activity from beginning to end. Synonymous with “paper trail.”

Can be paper and/or electronic

Written records that document a process, activity, or event.

A reliable and easy to follow audit trail is an indicator of good internal controls.



# Types of Audits

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Financial

Compliance

Information Systems

Operational

# Types of Audits

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## **Financial**

Reviews financial transactions to verify if assets, liabilities, authorizations, and receipt and disbursement of funds are properly and accurately recorded and reported.

Annually, CPA firm expresses an opinion on the financial statements

Compliance

Information Systems

Operational

# Types of Audits

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Financial

**Compliance**

Adherence to laws and regulations

Information Systems

Operational

# Types of Audits

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Financial

Compliance

**Information Systems**

System access

Physical security

Back-up

Confidentiality

Operational



# Types of Audits

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Financial

Compliance

Information Systems

## **Operational**

Examines the use of resources to determine if they are being used in the most effective and efficient manner to fulfill the organization's mission and objectives.

Evaluates internal controls

An operational audit may include elements of the other audit types listed above.

# External vs. Internal Audit

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## **External Audit**

Annual financial statement audit by CPA

Federal and State Government Audits

Department of Education

IRS

Grants

Financial Aid

Sales and Use Tax

Payroll

Financial Aid

## **Internal Audit**

# What is Internal Audit?

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“An independent, objective assurance and consulting activity designed to add value and improve an organization’s operations.”

*Institute of Internal Auditors*

# What Do Internal Auditors Do?

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Identify and evaluate organizational risk

Ensure internal control systems are well-designed and effective relative to those risks

Review records and obtain information by interviews, questionnaires, and physical inspections

Make recommendations to improve or establish internal controls

Follow up to ensure corrective actions are implemented

# Myths About Internal Auditors

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“You guys do taxes – right?”

Solely focus on financial records

Auditors are nitpickers and fault finders

It's best not to tell the auditors anything unless they specifically ask

Internal audit is the corporate police function



# When Will My Department Be Audited?

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## Internal Audit annual plan

Departments are generally notified in advance

Cashiering areas may be subject to surprise cash counts

## Fiscal year-end

Financial statement audits

No set time frame – but will be notified in advance

Department of Education

Granting agencies

# What to Do If Your Department is Audited?

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# What to Do If Your Department is Audited?

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Does *not* mean you did something wrong

Prepare to be interviewed

Provide appropriate documents



# What Happens During an Audit?

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Risk Assessment determines areas of potential risk:

Cash, hazardous waste, identity theft, security threats, etc.

Requests for documents

Internal Control Questionnaire (ICQ)

Review of policies and procedures

Interviews with management and staff

Testing – **Trust but Verify**



# Preparation for an Audit

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Question:

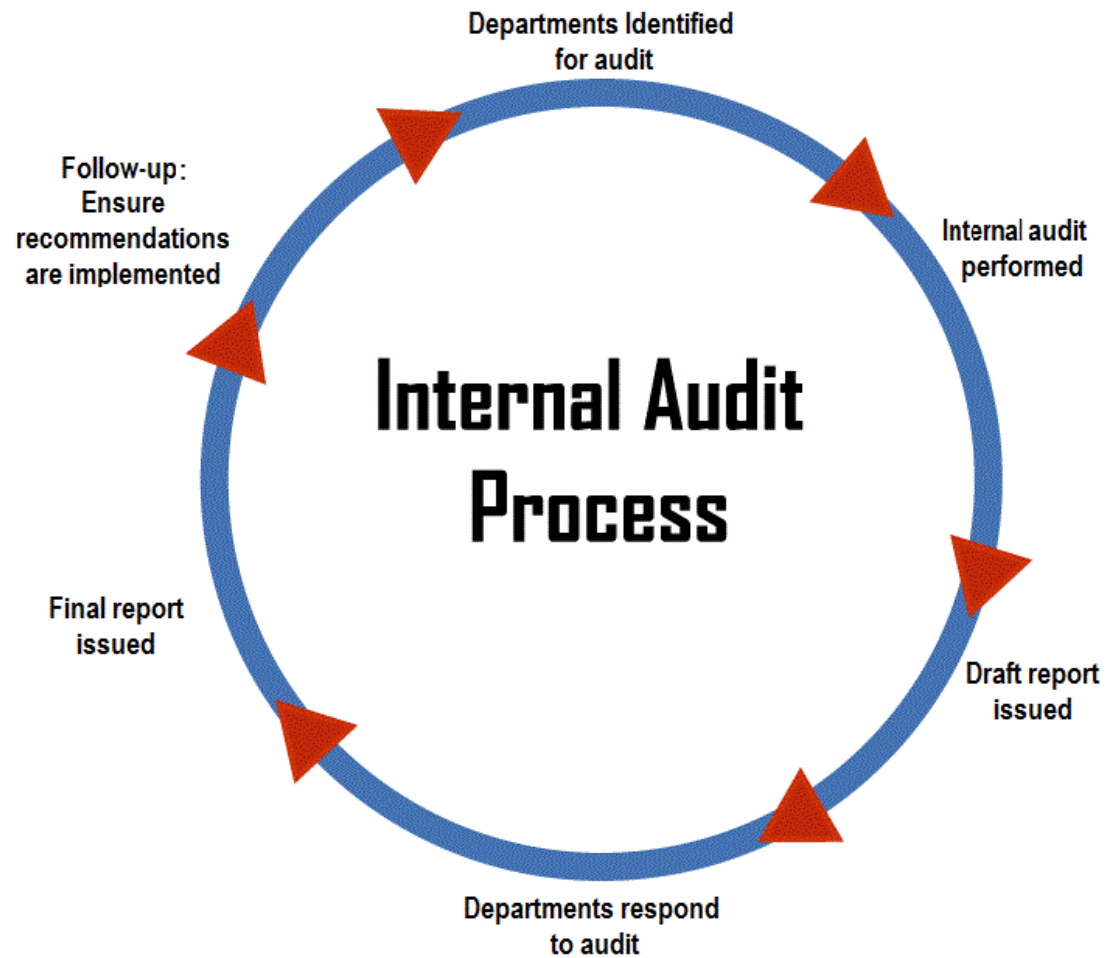
When do you begin preparing for an audit?

Answer:

Always be prepared for an audit.

# The Internal Audit Process

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# Risk and Internal Controls

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## Risk definition:

Any issue that could impact the ability of the institution to meet its objectives.

## Types of risk:

Financial

Operational

IT

Safety

Personnel

Compliance

Reputation

# Risks in the University Environment

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Loss or misuse of valuable resources

Negative publicity and legal costs

Reduced funding

Reduced private contributions

Disallowances on contracts and grants

Risks can be mitigated by effective *Internal Controls*

# What Are Internal Controls?

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Steps taken to obtain reasonable assurance that objectives are achieved.

The policies and procedures that help ensure management directives are carried out.

That sounds kind of technical.  
What does it mean in layman's terms?

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# Internal Controls

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Internal Controls are those processes that management relies on to make sure things *don't get goofed up*.



# Personal Internal Control Systems

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When you go to work, do you lock the doors to your house?

Do you keep the PIN number of your ATM card confidential and in a safe place?

Do you reconcile your checking account each month?

Do you compare credit card statement charges with your signed receipts?



# Similar Internal Controls at the University

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Offices, buildings, labs, and state vehicles are kept locked when unoccupied

Computer passwords are periodically changed and shouldn't be written down

Checking management reports and purchase card charges against source documents

Locked cash drawers and safes

Authorizations required for certain activities

# Types of Internal Controls

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Internal control activities can be:

Preventive

Detective

# Preventive Controls

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Preventive controls attempt to deter or stop undesirable events from occurring.

Preventive controls are proactive and help to prevent loss.

# Preventive Controls Examples

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Segregation of duties

No single individual should have control over two or more phases of a transaction or operation

Proper authorization

Supporting documentation

Physical safeguards against fire and theft

Using passwords to protect computer files



# Detective Controls

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Detective controls attempt to identify undesirable acts

Detective controls provide evidence that a loss has occurred  
*after the fact.*

Detective controls do not prevent a loss from occurring



# Detective Controls Examples

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Reconciliations

Reviews

Analyses

Investigation of discrepancies

Physical inventories

Audits

# Case Studies: Objectives, Risks, and Internal Controls

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## Objectives

Every entity has goals it intends to accomplish

## Risks

Threats to achievement of objectives

## Internal Controls

Tools to mitigate or manage risk



# Internal Control Framework Case Study – Getting to work

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## Objective

Getting to work on time.





# Internal Control Framework Case Study – Getting to work



<u>Risk</u>	<u>Internal Control</u>
Traffic	Listen to traffic reports
Parking	Arrive early
Speeding ticket	Follow the speed limit
Car breakdown	Schedule regular maintenance
Flat tire	Examine tires
Getting up late	Set an alarm clock
Accident	Drive defensively
Run out of gas	Observe fuel gauge
Illness	Healthy diet, exercise, wellness check-ups
Dead battery	Check headlights, store jumper cables

# Internal Control Framework Case Study– Student Timesheet

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A student worker on a research grant delivered her timesheet for processing after obtaining her supervisor's signature.

**See a problem?**

# Internal Control Framework Case Study– Student Timesheet

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The student falsified her hours after the professor approved the timesheet.

She forged signatures and bypassed the approval process.

An employee questioned the signatures

Consequence to student:

- Expelled

- Criminal conviction

- Served jail time

# Internal Control Framework Case Study– Student Timesheet

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Objectives

Risks

Internal Controls

# Internal Control Framework Case Study– Student Timesheet

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## Objectives

Allowable expenditures

Account for grant expenditures

Pay authorized wages

# Internal Control Framework Case Study– Student Timesheet

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## Risks

Fraud – theft of funds

Waste, abuse, and misuse of resources

Loss of future grants

Loss of reputation and negative publicity

# Internal Control Framework Case Study– Student Timesheet

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What Internal Controls should be implemented?

Segregation of duties

Students don't deliver timesheets

Reconciliations

Verification of authorized signatures



# Internal Control Framework Case Study– Grade Reporting

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Several students reported that the final grades they expected were not what they received.

**How could this happen?**



# Internal Control Framework Case Study– Grade Reporting

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Objectives

Risks

Internal Controls

# Internal Control Framework Case Study– Grade Reporting

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## Objectives

Right grades are reported

Security of grade reporting

# Internal Control Framework Case Study– Grade Reporting

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## Risks

Fraudulent Grade Reporting

Errors

Reputation – makes the University look vulnerable

# Internal Control Framework Case Study– Grade Reporting

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What Internal Controls should be implemented?

Reconciliations

System access

Users receive notification if password has changed.

Never share passwords

# Responsibility for Internal Controls

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**Management** is responsible for developing an appropriate system of internal controls.

**Every employee** is responsible for following and applying those practices.

# Quiz

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Any questions before we begin the quiz?



# Contact Information

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